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Ian Mackintosh ^a

^a Accounting Standards Board , E-mail:

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Discussion of 'What has the invisible hand achieved?'

Ian Mackintosh*

I found the presentation both interesting and timely. Ross has challenged the status quo and the basis of our current thinking in a very direct way. It is timely because we are in the middle of a long-running debate on the use of fair values and other measurement bases that Ross would definitely label as 'soft' figures.

The conceptual framework is being revisited at a fundamental level, and Ross's strongly held views would probably move the framework in the opposite direction to which it is likely to move.

His comments are especially relevant, too, in relation to the convergence programme being undertaken by the IASB and FASB. There are many that think this programme should be implemented slowly and carefully. Others think it should not be undertaken at all at this stage. Ross has indicated that he is not a great fan of FASB and that board's standards, so I would guess that he is not a supporter of the convergence programme.

I found the background that he gave on accounting conservatism extremely interesting. There is certainly a move away from conservatism and towards neutrality in accounting today, and perhaps we are forgetting the reason it was first introduced and the needs it is meant to address. In the UK we are currently looking at revenue recognition in service industries in UITF 40. In the view of some, this interpretation is an unfortunate move away from conservatism and towards the soft figures that Ross warns us against. I can tell you from personal experience that there are many practising accountants in the UK market who think that UITF 40 is taking us down the wrong path. On the other hand, many agree with it.

Ross's paper is firm in its conclusion that accounting needs to report figures that are verifiable or 'hard'. Soft figures will give rise to noisy income statements and frauds will increase, he asserts. If we persist in reporting soft figures he opines that the market will create its own figures

that are more useful to it.

To me this 'hard' verse 'soft' figures argument is another way of looking at the balance between relevance and reliability. In standard-setting this is always a major challenge. Ross would have us leaning heavily on the reliability side of the scale. I am not sure that very hard figures that may not tell you much about the entities' performance are the right thing to report. In fact, those figures may distort the entities' result. I think getting the balance right is much more difficult than Ross portrays and that getting it right is important. I am not a supporter of his emphasis on verifiability in all circumstances.

I have full sympathy with his comments on political forces and financial reporting. Over the years I have seen many instances of the sort of influence he refers to. It is not just a US problem; it happens all over the world. He cautions that standard-setters should be aware of the likely reactions to their proposed standards and to be sure that the reporting being required can work in practice. This is common sense. But situations do arise where, in the interests of better reporting, a standard-setter has to do something that they know will not be popular and will be rigorously opposed by some sectors of the community. In such situations it would be appropriate to try and mitigate adverse comment as much as possible. However, this should not, in my opinion, be at the cost of an effective standard. I am not as pessimistic as Ross on the acceptability of such a standard, and I think that history is on my side.

I believe that there is room for, and a need for, idealism in standard-setting. I do not think it is just a matter of noting market attitudes and responding to them. Further, I do not agree that the application of such idealism, with appropriate caution, will lead to the end of standard-setting as we know it.

Of course, financial reporting needs to meet the needs of the market. But there are times for leading the market and times for following it. Getting that balance right is the art of the standard-setter. The current standard-setters have probably not got it perfectly right and there is room for debate on all their decisions, but overall I do not share the view put forward that they are way off course and heading down a route of self destruction.

*The author is Chairman, Accounting Standards Board. The comments that appear in this article are the personal views of the author and not those of the ASB. ASB positions on accounting and disclosure issues are arrived at by the board after the completion of an extensive process of public consultation and disclosure. E-mail: imackintosh@frc.org.uk